

## CREDIT OPINION

3 June 2022



Send Your Feedback

### Contacts

**Brad Spielman** +1.415.274.1719  
 VP-Sr Credit Officer  
 brad.spielman@moodys.com

**Daniel Steingart, CFA** +1.949.429.5355  
 VP-Sr Credit Officer  
 daniel.steingart@moodys.com

### CLIENT SERVICES

**Americas** 1-212-553-1653  
**Asia Pacific** 852-3551-3077  
**Japan** 81-3-5408-4100  
**EMEA** 44-20-7772-5454

## Sutter Health, CA

Update following revision of outlook to stable

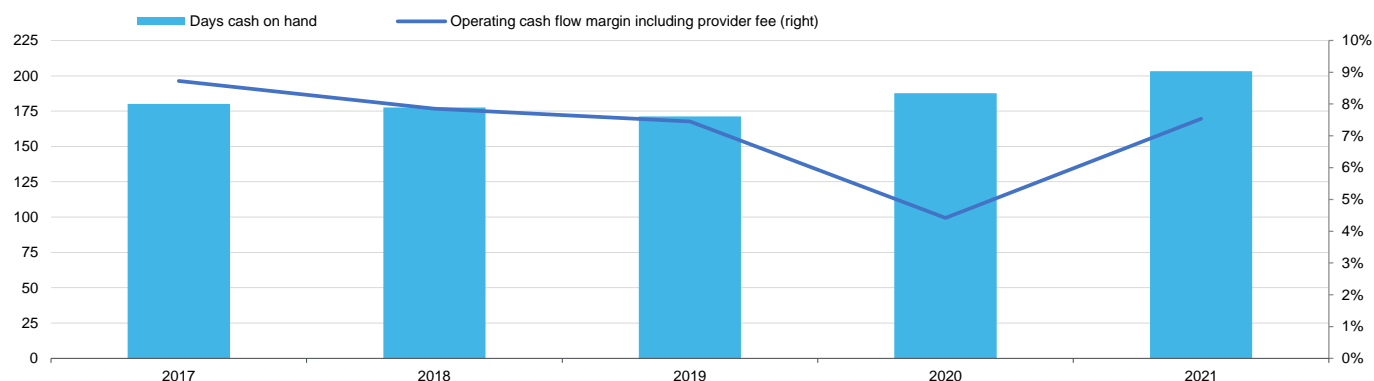
### Summary

Sutter Health's (A1 stable) good credit profile reflects our expectation that recent operating improvements will be sustained, and that current balance sheet and leverage measures will not materially weaken from current levels. Following weak operating results in 2020 and through the first quarter of 2021 (which were reflected in our last review), operations improved considerably through the remainder of 2021, resulting in favorable results for the year. Similarly, results through the first quarter of 2022 remained comparatively strong, and despite headwinds relating to a union strike and ongoing labor expense challenges, results for full year 2022 are expected to be on par with 2021 (when normalizing for the provider fee). This is a significant driver of the revision of the outlook to stable from negative. Other ongoing strengths which support the A1 rating include: Sutter's strong presence in northern California; its large size; its favorable market position in each of its markets; its comprehensive array of strong clinical offerings; its conservative asset-liability structure (including a large pension plan that has historically been well funded); and its integrated nature.

Sutter's strengths are moderated by a number of challenges, including: an expensive cost structure driven by high wage rates; a difficult payer environment with only modest increases expected over the next year; and significant competition in most markets. Additionally, Sutter has contracts with various unions equal to about 25% of its workforce which periodically have been a source of operating stress. To that point, the contracts with the California Nurses Association (CNA) are currently open, and CNA staged a one day strike in April which required Sutter to procure replacement staffing. This could be a source of additional operating pressure in the months ahead. Other organizational challenges include: liquidity that remains below the medians for the rating category, despite recent improvement; and debt measures which remain comparably modest.

On May 31, 2022, Moody's affirmed Sutter Health's A1 revenue bond rating, and revised the outlook to stable from negative

Exhibit 1

**Balance sheet and operations show improvement, supporting the revision of the outlook to stable**

Based on audited financial statements for Sutter Health, for fiscal years ended December 31; California State provider fee included in the calculation of operating cashflow margin and excluded from the calculation of days cash on hand; expenses in 2019 reduced by \$644 million relating to a lawsuit settlement and other one-time items; unrestricted cash and investments in 2020 exclude \$400 million relating to a draw on a line of credit and \$1.2 billion relating to Medicare Advance Payments (MAP) and deferred payroll tax; unrestricted cash and investments in 2021 exclude \$801 million relating to MAP and deferred payroll tax

Source: Moody's Investors Service

**Credit strengths**

- » Sutter will continue to benefit from its favorable strategic position, consisting of a large contiguous footprint in Northern California, 29 acute care facilities, a high number of outpatient access points, and over 3,700 aligned physicians
- » Operating margins are expected to sustain the gains achieved over the last year
- » The healthy condition of Sutter's physical plant will remain a credit positive; having completed a large-scale, 20-year, seismic preparedness project, management intends to maintain capital spending at a rate approximate to depreciation
- » Sutter's conservative asset-liability policy will remain a strength, consisting of all fixed rate debt, no swaps, and a historically well-funded pension program
- » The California State provider fee program is expected to continue to provide needed and very material ongoing operating support, though the timing of payments will likely remain variable

**Credit challenges**

- » Despite improvements, liquidity is expected to remain below the medians for the rating category
- » While no additional debt is currently expected, debt measures will likely remain weaker than many similarly rated peers
- » Sutter will continue to face material competition in most major markets from large and financially solid healthcare systems
- » Union activity will remain a risk
- » Certain markets will likely remain challenging, including San Francisco, and other portions of the Bay Area
- » Various headwinds will continue to pressure margins, including the labor shortage, high wage rates, inflation, and ongoing uncertainty related to COVID

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

## Rating outlook

The revision of the outlook to stable from negative reflects our expectation that recent operating improvements will be maintained, and that debt and balance sheet measures will not materially weaken from current levels.

## Factors that could lead to an upgrade

- » Significantly improved debt and balance sheet measures
- » Sustained material improvement of operating measures

## Factors that could lead to a downgrade

- » Additional dilution of balance sheet and debt measures beyond expectations
- » Return to weaker operating margins
- » Material additional disruption due to labor action

## Key indicators

Exhibit 3

### Sutter Health, CA

	2017	2018	2019	2020	2021
Operating Revenue (\$'000)	11,623,000	12,120,000	12,725,000	12,737,000	13,711,000
3 Year Operating Revenue CAGR (%)	5.9	4.5	4.0	3.1	4.2
Operating Cash Flow Margin (%)	5.6	6.0	5.8	3.3	6.5
Operating Cash Flow Margin including Provider Fee (%)	8.7	7.9	7.4	4.4	7.5
PM: Medicare (%)	42.0	43.0	44.0	43.0	43.0
PM: Medicaid (%)	19.0	19.0	18.0	19.0	19.0
Days Cash on Hand	180	178	171	188	203
Unrestricted Cash and Investments to Total Debt (%)	142.1	128.2	136.0	143.0	161.7
Total Debt to Cash Flow including Provider Fee (x)	2.8	3.4	3.4	4.8	3.1

Based on audited financial statements for Sutter Health, for fiscal years ended December 31; California State provider fee excluded from calculations unless indicated otherwise; investment returns normalized at 5%; expenses in 2019 reduced by \$644 million relating to a lawsuit settlement and other one-time items; unrestricted cash and investments and debt in 2020 exclude \$400 million related to a draw on a line of credit; additionally, unrestricted cash and investments exclude Medicare Advance Payments and deferred payroll tax totaling \$1.2 billion in 2020 and \$801 million in 2021

Source: Moody's Investors Service

## Profile

Sutter Health is the not-for-profit parent of affiliates that make up a large health system centered in Northern California. The system includes 29 acute care facilities, a small health plan, a large number of out-patient facilities, and two medical foundation corporations that contract with medical groups that account for the services of over 2600 physicians. In fiscal 2021, Sutter Health had over \$14 billion in revenues, and generated nearly 182,000 admissions.

## Detailed credit considerations

### Market position: large, integrated, geographically focused delivery system; good revenue growth expected to continue

Sutter will continue to benefit from its well-established business strategy, which consists of providing a full spectrum of services within its northern California footprint. Sutter's contiguous footprint enables numerous operating efficiencies, and Sutter has successfully lowered certain costs over the last several years, and has streamlined system-wide operations. Sutter has a favorable clinical reputation,

and the vast majority of its 29 hospitals are substantial in size, and provide high acuity services. Additionally, Sutter is well integrated with its physician networks, and it has a substantial clinic presence throughout its footprint. Sutter's retail footprint includes store front walk-in clinics, and 25 of these are currently in operation. Other investments include the development of a number of surgery centers, the expansion of the Sutter Health Plus network (consisting of more than 90,000 members as of FYE 2021), and a new partnership with Stanford Health to establish a large comprehensive cancer center in the east bay, which is currently under construction.

Following a multi-year trend of declining results, which was then exacerbated by the pandemic in 2020, Sutter undertook an aggressive approach towards improving performance, including: a major voluntary reduction in force affecting 800 FTE's; closing a specialty hospital in Menlo Park; closing the NICU at Sutter Delta; and closing labor and delivery at Sutter Solano. Despite this retrenchment, growth was very strong in 2021, with utilization measures improving in every category, and with revenues growing by 14% (excluding the impact of CARES funding). We believe that management's willingness to reevaluate all aspects of its business plan is a credit strength. Management continues to strategically invest within its current footprint, which should result in the continuation of good revenue growth.

Since last review, two major lawsuits have been resolved. The UFCW lawsuit, which the parties agreed to resolve for \$575 million in 2019, received final court approval in 2021. This resulted in the payment of the agreed amount, as well as the implementation of certain terms governing Sutter's payer contracting practices that were agreed upon by the parties through a stipulated injunction. These agreed-upon terms will govern certain aspects of Sutter's payer contracting practices during the period of the stipulated injunction. The \$575 million was included as an operating expense on Sutter's income statement in 2019, and came off Sutter's balance sheet in 2021. A second lawsuit - Sidebe - proceeded to a jury trial earlier this year, and was decided in Sutter's favor. While appeals may continue, the resolution of these lawsuits, which have been ongoing for nearly ten years, should allow the organization to refocus on its strengths, and move forward strategically.

Other ongoing challenges include material competition in all of Sutter markets, and certain disadvantages in the operating environment. Competitors include Kaiser Permanente, Dignity Health (part of CommonSpirit Health) and various regional systems. Additionally, operating exclusively in California exposes Sutter to certain California-specific challenges, including: very high labor costs; unfunded operating mandates such as required minimum nurse staffing levels; high managed care penetration; high construction costs; seismic retrofit requirements; and low state reimbursement for Medi-Cal. An additional challenge in California is organized labor, which historically has taken a somewhat aggressive stance towards Sutter at different times over the years. To that point, the contracts with the California Nurses Association (CNA) are currently open, and CNA staged a one day strike in April which required Sutter to procure replacement staffing. This could be a source of additional operating pressure in the months ahead.

### **Operating performance, balance sheet, and capital plans: improved operating and balance sheet measures are expected to be maintained**

We expect Sutter to sustain the operating improvements achieved over the last year despite the ongoing presence of significant headwinds. Strong revenue growth and good recovery of utilization, combined with strategic investments and targeted cost cutting strategies, resulted in materially improved performance in 2021, despite significantly reduced CARES funding versus the prior year (Sutter booked \$791 million of CARES funds in 2020, versus just \$59 million in 2021). Results through the first quarter of 2022 remain favorable, including an additional \$88 million of CARES funds, but excluding any provider fee dollars which have been delayed. Significant headwinds will continue through the remainder of the year and possibly beyond, including: possible additional labor action; the possible continued delay of provider fee funds (the most recent program has not yet been approved by CMS); ongoing very high labor costs; continuation of the labor shortage; inflation; and the possible continued disruption from COVID. Nevertheless, management has demonstrated an ability to achieve stable results despite various challenges, and we expect results to 2022 to still show considerable improvement versus 2020. Longer term, operating cashflow margins are expected to be maintained in the high single digits.

### **LIQUIDITY**

We expect days cash on hand to remain at near current levels (excluding Medicare Advance Funds and deferred payroll tax). Unrestricted cash and investments improved for the second consecutive year despite the payment of the UFCW settlement in 2021. Improvements were driven by strong investment returns and the monetization of a number of assets, driving days cash on hand to over 200 days at FYE 2021 (excluding provider fee expenses from calculations). There may be some decline this year due to investment

market volatility and the resumption of Sutter's capital plan (albeit at a lower level), yet long term liquidity should remain generally within current ranges. Management has targeted 175 days as a floor on liquidity, and believes it may remain well above this, which is an improvement over the past.

As of FYE 2021, investment allocation consisted of 40% cash and fixed income, 26% equities, and 34% alternatives. 69% of all unrestricted cash and investments can be liquidated within 30 days.

#### **CAPITAL INVESTMENT**

Sutter has successfully completed a 20-year master facilities plan entailing the seismic upgrade of many of its most significant medical centers. Capital spending was particularly low in 2020 and 2021, averaging 0.5 times depreciation. Sutter is moving forward with a number of delayed projects in 2022 resulting in increased capital spending, but to levels that are historically still somewhat modest, measuring a little over 1.0 times depreciation.

#### **Debt structure and legal covenants: debt measures remain modest for the rating category**

A historic challenge for the organization has been its relatively high debt load. Debt measures have improved over the last couple of years, but remain below the medians for the rating category. We expect debt measures to not weaken below current levels.

#### **DEBT STRUCTURE**

Sutter's debt structure is favorably conservative consisting of all fixed rate debt, and no swaps. The organization has taken on more market access risk in recent years with the issuance of a number of taxable bullet maturities, with \$300 million coming due in 2025, \$350 million coming due in 2028, and \$700 million coming due in 2030 (among other longer dated bullets). Nevertheless, we believe the absence of material exposure to interest rate volatility, put risk, bank renewal risk, or swap mark-to-market risk, are important mitigants to Sutter's somewhat high leverage.

#### **LEGAL SECURITY**

A new MTI was implemented concurrent with the 2020 bond transaction. Under the new MTI, bonds are secured by a gross receivables pledge. All members of the Obligated Group are jointly and severally liable with respect to the payment of each obligation secured under the MTI. Financial covenants of the MTI and Sutter's credit facility include a debt service coverage requirement of over 1.1 times, and a days cash on hand requirement of over 70 days. In 2021, Sutter posted sufficient headroom on all of its covenants.

#### **DEBT-RELATED DERIVATIVES**

None

#### **PENSIONS AND OPEB**

Sutter has historically had the practice of keeping its defined-benefit pension program well funded. At FYE 2021, the program had a funded ratio of 98%. Other indirect debt includes operating lease liabilities, which is also relatively low at \$479 million. Overall, Sutter's low amount of indirect debt is an important mitigant to its high level of direct debt.

### **ESG considerations**

#### **Environmental**

Sutter's largest exposure to environmental risk is wild fires, which have occurred in various of Sutter's service areas in recent years, and have affected operations. Mitigants to this include Sutter's geographic diversification within its foot print, a certain level of balance sheet strength, and other resources that come from the organization's size, structure, and importance.

#### **Social**

Social considerations include the high cost of living in Northern California, high cost of construction, a challenging payer mix, high managed care penetration, and various unfunded mandates from the state. Additionally, Sutter operates in a politicized environment which has resulted in a high level of legal activity, and Sutter's exposure to unions is high, which recently resulted in a strike. Favorably, the system benefits from California's provider fee program which is correlated to Sutter's exposure to Medicaid, and which provides significant additional support. An additional social consideration is the ongoing impact of COVID, which remains an area of uncertainty, and which could result in further operating pressure.

### Governance

Sutter's current CFO joined in 2020, and came from outside the organization. Sutter's most recent CEO left in early January of this year, and a search for a permanent replacement is nearing conclusion. The former COO is currently serving as interim CEO, and there is an interim COO. The remainder of the senior management team has been stable. Additionally, Sutter benefits from a deep bench. Disclosure practices are standard.

© 2022 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S CREDIT RATINGS AFFILIATES ARE THEIR CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MATERIALS, PRODUCTS, SERVICES AND INFORMATION PUBLISHED BY MOODY'S (COLLECTIVELY, "PUBLICATIONS") MAY INCLUDE SUCH CURRENT OPINIONS. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT OR IMPAIRMENT. SEE APPLICABLE MOODY'S RATING SYMBOLS AND DEFINITIONS PUBLICATION FOR INFORMATION ON THE TYPES OF CONTRACTUAL FINANCIAL OBLIGATIONS ADDRESSED BY MOODY'S CREDIT RATINGS. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS, NON-CREDIT ASSESSMENTS ("ASSESSMENTS"), AND OTHER OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. AND/OR ITS AFFILIATES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS, ASSESSMENTS AND OTHER OPINIONS AND PUBLISHES ITS PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS, AND PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS OR PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing its Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY CREDIT RATING, ASSESSMENT, OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any credit rating, agreed to pay to Moody's Investors Service, Inc. for credit ratings opinions and services rendered by it fees ranging from \$1,000 to approximately \$5,000,000. MCO and Moody's Investors Service also maintain policies and procedures to address the independence of Moody's Investors Service credit ratings and credit rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold credit ratings from Moody's Investors Service and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at [www.moody's.com](http://www.moody's.com) under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any credit rating, agreed to pay to MJKK or MSFJ (as applicable) for credit ratings opinions and services rendered by it fees ranging from JPY100,000 to approximately JPY550,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER

1330664

## CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454